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4 UNITED STATES BANKRUPTCY COURT
5 NORTHERN DISTRICT OF CALIFORNIA

6 In re

7 DONALD O. GRACE,

No. 01-11078

8 Debtor(s).
9 _____/

10 Memorandum re Motion to Abandon
11 _____

11 I. Background

12 Debtor Donald Grace filed his Chapter 7 bankruptcy petition on April 12, 2001. Shortly after he
13 filed, the Estate of Jalmer T. Berg (“Berg”), holder of several deeds of trust on one of the debtor’s
14 properties, moved the court for relief from the stay to foreclose on the property, and sought to foreclose
15 judicially. The court had not yet heard the objection to Grace’s discharge and could see no reason why
16 judicial foreclosure was appropriate at that time. On June 6, 2001, the court granted leave to foreclose
17 non-judicially only. The court told counsel for Berg:

18 So I’m giving you relief to foreclose but not judicially without a
19 further order If you can come up with a good reason why you
20 need to foreclose judicially, I will give it to you, but as of right now,
I’m not hearing it.

21 On August 21, 2001, Berg foreclosed on his third deed of trust, his winning bid not sufficient to
22 allow any payment on his junior liens. In December, 2002, the court denied Grace’s discharge. Berg
23 thereafter sued Grace in state court on the notes secured by the junior liens. Grace raised California’s
24 anti-deficiency laws as an affirmative defense. Berg demurred to Grace’s answer, arguing to the state
25 court that only the bankruptcy estate could raise the defense. The state court sustained Berg’s position,
26 leaving open the possibility of reconsideration if the defense were abandoned. Grace now seeks that

1 relief from this court.

2 II. The Defense as Property of the Estate

3 This court does not agree with the state court's determination that Grace is not entitled to the
4 defense for two reasons. First, the defense arose when Berg foreclosed, which was after the petition
5 date; § 541(a)(1) of the Bankruptcy Code makes property owned by the debtor as of the commencement
6 of the case property of the estate. If the case had been commenced as a Chapter 11 Berg might have an
7 argument that the defense was acquired by the estate pursuant to § 541(a)(7), but this case has always
8 been a Chapter 7.

9 Second, and more crucially, there is nothing in the law which prohibits *both* a debtor and the
10 bankruptcy estate from asserting the same defense. If Berg had sued Grace on a claim barred by the
11 applicable statute of limitations or the subject of an accord and satisfaction, Grace would be permitted to
12 raise the defense in an action against him and the trustee would be entitled to raise the defense in
13 objecting to Berg's bankruptcy claim. Unlike a right to a setoff or a counterclaim, the right to assert a
14 pure defense is not limited to the estate alone.

15 That having been said, this court is not an appellate court. Since a pure defense is of no value to
16 the estate,¹ the court will direct its abandonment but not any right to a setoff or affirmative relief. Any
17 other relief must be obtained from the state courts.

18 III. Effect of Denial of Discharge

19 Having found that Grace has committed acts not entitling him to a discharge, there is a tendency
20 for the court to rule against Grace in all matters. The court must remind itself that the penalty for denial
21 of discharge is that Grace must defend claims of creditors as if there had been no bankruptcy. It is not
22 proper for the court to compound the punishment by stripping Grace of his defenses.

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25 ¹While Berg is free to settle with the bankruptcy trustee any claim he may have against the estate
26 arising out of the foreclosure, it would be manifestly inequitable to allow Berg to purchase Grace's right
to defend from the estate.

1 IV. Effect of the Stay Relief Order

2 The order presented by Berg reflecting the court's granting of relief from the automatic stay to
3 foreclose non-judicially had a strange provision, that "Creditor [Berg] shall file a proof of claim in this
4 court as to any unsecured claim he has as a result of the foreclosures." The court did not understand this
5 provision but knew it was not in the business of ordering parties to file claims so it struck "shall" and
6 replaced it with "may." Berg now argues that the order somehow modified California anti-deficiency
7 laws.

8 The court intended nothing of the sort. It only ordered that Berg could file a claim if it wanted to.
9 It did not specify that such a claim would be allowed or that any defense to the claim was waived. To
10 correct this misuse of the order, the court will enter an amended order replacing the order of June 14,
11 2001, and eliminating everything after "proceedings" in the last paragraph.

12 V. Conclusion

13 While the court doubts that the right to assert anti-deficiency laws is an exclusive right of the
14 bankruptcy estate, the court will defer to the ruling of the state court and issue an order providing that, to
15 the extent is property of the estate it is deemed abandoned, although any right to a setoff or counterclaim
16 or other affirmative relief is not abandoned.² The court will prepare this order. Counsel for Grace
17 shall submit an amended order for relief from the stay as provided above.

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19 Dated: October 4, 2003

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Alan Jaroslovsky
21 U.S. Bankruptcy Judge
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26 ²To the extent this is different from the court's oral ruling, the court has changed its mind.

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